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IN THE

Supreme Court of The United States

OCTOBER TERM, 1983

ROBERT D. KEARNEY,

Petitioner,

vs.

WARREN EHRICHS, and WILBERT EHRICHS, LEONARD EHRICHS AND WARREN EHRICHS, AS CO-ADMINISTRATORS OF THE ESTATE OF MINNIE C. EHRICHS, DECEASED,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

1. When an appeals court *sua sponte* inserts a wholly new theory and cause of action, in its opinion on the merits, under the guise of a Rule 15(b), F.R.Civ.P. amendment to the complaint, upon which theory the cause was neither tried, nor briefed, nor argued, and the appeals court orders entry of a money judgment solely upon the inserted cause of action, has the defendant been deprived of his property without due process of law?

2. When an appeals court *sua sponte* adds *a new party-plaintiff* to a lawsuit, for the first time in its opinion on the merits (post-trial, post-briefing, and post-argument), and in its opinion orders entry of a money judgment in favor of the new party-plaintiff, has the defendant been deprived of his property without due process of law?

3. What standards are applicable in determining whether, under Rule 15(b), F.R.Civ.P., the parties have "impliedly" consented to trial of an issue that is outside the pleadings?

PARTIES TO THE PROCEEDING

Pursuant to Rule 21.1, subparagraph (b), Rules of the Supreme Court of the United States, petitioner states that the only adverse party appearing in the court of appeals was Warren Ehrichs, individually, a respondent herein. In the district court, the only adverse party appearing was the same respondent, Warren Ehrichs.

In the majority opinion of the court of appeals, respondent Warren Ehrichs, as administrator of the Estate of Minnie C. Ehrichs, Deceased, was added as a new adverse party to the proceedings.

In this Court, the remaining two co-administrators of the Estate of Minnie C. Ehrichs, Deceased, namely Wilbert Ehrichs and Leonard Ehrichs, are added as respondents, and new adverse parties, pursuant to N.D. Cent. Code § 30.1-18-17 (Uniform Probate Code § 3-717),* which requires joint action in estates wherein co-administrators have been appointed, such as *In the Matter of the Estate of Minnie C. Ehrichs, Deceased*, Probate File No. 5117, County Court, Traill County, State of North Dakota. (App. at 49-52.)

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*N.D. Cent. Code (North Dakota Century Code) § 30.1-18-17 provides as follows:

> Co-representatives—When joint action required. — If two or more persons are appointed co-representatives and unless the will provides otherwise, the concurrence of all is required on all acts connected with the administration and distribution of the estate. This restriction does not apply when any co-representative receives and receipts for property due the estate, when the concurrence of all cannot readily be obtained in the time reasonably available for emergency action necessary to preserve the estate, or when a co-representative has been delegated to act for the others. Persons dealing with a co-representative, if actually unaware that another has been appointed to serve with him or if advised by the personal representative with whom they deal that he has authority to act alone for any of the reasons mentioned herein, are as fully protected as if the person with whom they dealt had been the sole personal representative.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The petitioner, Robert D. Kearney, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered in this proceeding on March 28, 1984.

OPINIONS BELOW

The opinion of the court of appeals is reported as follows: *Ehrichs v. Kearney*, 730 F.2d 1170 (8th Cir. 1984). (App. at 18.)[1]

1. Citation abbreviations are Appendix ("App."); Trial Transcript ("Tr."); and Trial Exhibit ("Ex.").

The opinion of the district court is unreported; it appears in the Appendix hereto. (App. at 36.)

JURISDICTION

The judgment of the United States Court of Appeals for the Eighth Circuit was entered on March 28, 1984, at 9:30 o'clock a.m. C.S.T. A timely petition for rehearing *en banc* was denied on April 26, 1984, and this petition for writ of certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. §§ 1254(1) and 2101(c).

CONSTITUTIONAL PROVISIONS AND RULES OF PROCEDURE INVOLVED

The constitutional provision involved in this case is the Due Process Clause of the Fifth Amendment to the United States Constitution, which provides "... nor shall any person ... be deprived of life, liberty, or property, without due process of law ...."

The rule of procedure involved in this case is Rule 15(b), Federal Rules of Civil Procedure (F.R.Civ.P.), which provides in part:

> Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings....

STATEMENT OF THE CASE

On April 20, 1979, The Fargo National Bank foreclosed (a foreclosure pursuant to voluntary consent of the debtor) on the assets of Ehrichs Manufacturing Co., Inc. (hereinafter "Ehrichs Manufacturing"), a North Dakota corporation, of which re-

spondent Warren Ehrichs was the major stockholder. At the time, Ehrichs Manufacturing was heavily involved in manufacturing a curb-and-gutter machine—a machine capable of producing poured concrete curb and gutter, on site, without the necessity of concrete forms normally used in that type of work. After the bank foreclosed, Warren Ehrichs and petitioner reached an oral agreement to go into business together to continue to produce and market the curb-and-gutter machine (on a 49%-51% stock ownership basis), and based on that agreement the bank sold and assigned its position as secured party-in-possession to petitioner. Respondent Warren Ehrichs then reneged on his part of the agreement, and decided he would not go into business with petitioner. He and petitioner then entered into a second, separate agreement for transfer of respondent Warren Ehrichs' stock in Ehrichs Manufacturing to petitioner. In return, as the district court found, petitioner agreed to release respondent Warren Ehrichs from his obligations under the original oral agreement, and also agreed to "settle the debts of Ehrichs Manufacturing". (App. at 41.)

Respondent Warren Ehrichs later commenced this action against petitioner in Cass County District Court, East Central Judicial District, State of North Dakota. Based on diversity jurisdiction, the matter was timely removed to the United States District Court for the District of North Dakota, Southeastern Division, pursuant to 28 U.S.C. §§ 1332 and 1441-1450.

In the first amended complaint served and filed in the district court at the pretrial conference on September 8, 1982, respondent Warren Ehrichs asserted claims against petitioner under three theories: (1) rescission and fraud, alleging that petitioner entered into the initial oral agreement with no

intention of complying with it; (2) a Uniform Commercial Code (hereinafter "UCC") claim for an accounting of surplus on liquidation of assets of Ehrichs Manufacturing, under N.D. Cent. Code §§ 41-09-48, subsection 2, and 41-09-50, subsection 2; and (3) unjust enrichment.

A bench trial was held beginning November 29, 1982 before the Honorable Paul Benson, Chief Judge, United States District Court for the District of North Dakota. Upon conclusion of trial and after submission of post-trial briefs, the district court rendered its decision on April 8, 1983 (App. at 36), holding: (1) petitioner did not defraud respondent Warren Ehrichs, and respondent Warren Ehrichs, not petitioner, was the party who breached the initial oral agreement; (2) respondent Warren Ehrichs was not entitled to an accounting for surplus under the UCC; and (3) respondent Warren Ehrichs was not entitled to recover under a theory of unjust enrichment. Judgment dismissing the first amended complaint and cause of action was entered on the same date, April 8, 1983.

Respondent Warren Ehrichs appealed the district court's decision on the merits to the United States Court of Appeals for the Eighth Circuit, pursuant to 28 U.S.C. § 1291, with a timely notice of appeal being served and filed on May 6, 1983. In his appeal, respondent Warren Ehrichs abandoned his claim for rescission and fraud, and instead listed in his "Statement of Issues", and argued, only two issues: (1) his UCC claim for an accounting for surplus on disposition of assets of Ehrichs Manufacturing, and (2) his claim in unjust enrichment.

The case was argued to a three-judge panel of the court of appeals on December 12, 1983 in St. Paul,

Minnesota. On March 28, 1984, the United States Court of Appeals for the Eighth Circuit rendered its decision (App. at 18), holding that the district court correctly decided the UCC claim and the claim in unjust enrichment. (App. at 24.) However, a majority of the panel went on to hold that the parties had "fairly tried" two additional claims, involving two alleged corporate debts of Ehrichs Manufacturing: one owed to respondent Warren Ehrichs, individually, and the second owed to the estate of respondent Warren Ehrichs' deceased mother, Minnie Ehrichs, in amounts of $9,292.00 and $39,332.00, respectively. The majority then, under the guise of Rules 15(b) and 54(c), F.R.Civ.P., amended the pleadings *sua sponte* to insert the additional claims (based in contract), and proceeded to enter judgment on both of them against petitioner. (App. at 34.) The judgment as entered by the court of appeals was in favor of the named plaintiff, respondent Warren Ehrichs, and also in favor of a *new plaintiff added to the lawsuit for the first time in the majority opinion of the court of appeals*, the Estate of Minnie Ehrichs. The majority opinion based its holdings of "fairly tried" on Ex. 67, an exhibit offered in evidence at trial by petitioner, being an accountant's summary of the business records of Ehrichs Manufacturing which was offered *specifically* on the issues of accounting for surplus under the UCC, and unjust enrichment. (Tr. at 27, 1.9-24). Ex. 67 included some 135 debt entries reflected in the books of the corporation, of which the alleged debts owed to respondent Warren Ehrichs and to his mother were only two—*i.e.*, respondent Warren Ehrichs and his mother were two creditors of the corporation, out of 135. In this dissenting opinion, Circuit Judge Fagg states:

> The unfairness resulting from reliance on a theory not advanced in the district court only com-

> pounds the prejudice which flows from the majority's raising an issue on appeal that was not submitted in the briefs. Kearney [petitioner] is thus not only denied the opportunity to present evidence on the new theory, but is in addition precluded from advancing arguments on appeal pertinent to the rationale of the majority's decision. Indeed, the outcome on appeal is beyond the realm of possibilities that Kearney [petitioner] might reasonably have foreseen. Without a minimum assurance of predictability on the part of this court, parties will simply be at a loss to decide what arguments and theories they should pursue on appeal. We should not raise and decide issues on our own motion without ensuring that the parties have had a fair opportunity to present evidence and arguments bearing on the resolution of those issues.

(App. at 31.)

A timely petition for rehearing *en banc* was filed and served by petitioner in the court of appeals on April 11, 1984. On April 26, 1984, that court entered its order denying the petition for rehearing *en banc.* (App. at 33.) On May 10, 1984, the district court entered its judgment pursuant to the mandate of the court of appeals (App. at 48), awarding damages against petitioner and in favor of respondent Warren Ehrichs, individually, and as administrator of the Estate of Minnie Ehrichs, Deceased (a new party-plaintiff, added for the first time in the majority opinion of the court of appeals), in a total amount of $48,624.00.

REASONS FOR GRANTING THE WRIT

1. The appeals court opinion below sanctions depriv-

ing a litigant of his property without ever affording him notice of, and any opportunity to contest, the claims against him.

Rule 15(b) F.R.Civ.P., provides in part:

> Amendments to Conform to the Evidence. When issues not raised by the pleading are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings.

As the rule plainly states, a Rule 15(b) amendment to a complaint to conform to the evidence presupposes one of two things—either the parties *expressly* consented to trial of new issues, not raised in the pleadings, or they *impliedly* consented to trial of new issues which are outside the pleadings. The former normally presents no due process implications; the latter may, simply because procedural due process requires that "it must be 'clear that the parties understand exactly what the issues are when the proceedings are had.'" *Conair Corp. v. N.L.R.B.*, 721 F.2d 1355, 1372 (D.C. Cir. 1983), quoting *Kuhn v. Civil Aeronautics Board*, 183 F.2d 839, 842 (D.C. Cir. 1950). As the court noted in *Armstrong Cork Company v. Lyons*, 366 F.2d 206 (8th Cir. 1966):

> A court may not, without the consent of all persons affected, enter a judgment which goes beyond the claim asserted in the pleadings. (Citing cases). Unless all parties in interest are in court and have voluntarily litigated some issue not within the pleadings, the court can consider only the issues made by the pleadings, and the judgment may not extend beyond such issues nor beyond the scope of the relief demanded. A party is no more entitled to recover upon a claim not pleaded than he is to recover upon a claim pleaded but not proved.

The foregoing rules are all fundamental and state

> *nothing more than the essentials of due process and of fair play. They assure to every person his day in court before judgment is pronounced against him.* They cannot be circumvented by allowing amendments to pleadings to change a cause of action after judgment or by giving notice of the entry of judgment or by entertaining motions to vacate a judgment after it has been entered.

Id. at 208, quoting *Sylvan Beach v. Koch*, 140 F.2d 852, 861-62 (8th Cir. 1944) (emphasis added).

This petition raises an issue for review that is fundamental to our system of resolving disputes in federal courts—how is a party-defendant, in a Rule 15(b) amendment-to-conform-to-the-evidence situation, to be guaranteed the fundamental requisites of due process under the Due Process Clause of the Fifth Amendment? How is such a defendent to be afforded: (1) proper notice of the claim against him, (2) an opportunity to be heard, and (3) a meaningful hearing? Although as this Court stated in *Mathews v. Eldridge*, 424 U.S. 319 (1976), what is required due process under the Due Process Clause of the Fifth and Fourteenth Amendments may vary as the " 'particular situation demands' "; *id.* at 334, quoting *Morrissey v. Brewer*, 408 U.S. 471, 481, (1972), it seems clear that insofar as procedural due process in the federal courts in concerned, the above three requisites are absolutely essential.

The law established by the majority opinion in this case allows a federal appellate court to deprive a defendant of his property without due process of law—the appeals court can: (a) seize upon a piece of evidence in the case, introduced at trial as relevant to an issue clearly raised in the pleadings, and (b) based on its incidental relevancy to an issue not pled, (c) use that piece of evidence to find *sua sponte* in its opinion

on the merits, that (d) the parties "impliedly consented" to try a new issue that is outside the pleadings. In this case, the very first "notice" petitioner had that two new issues had supposedly entered the case was when he received a copy of the majority opinion of the court of appeals—post-trial, post-appellate briefing, post-appellate argument.[2] A litigant in this position is thus not only deprived of any opportunity to defend against the new claims at the trial court level, or to offer evidence relevant thereto, but he is also precluded from advancing any appellate argument whatsoever on the merits of the claims, or on the prejudicial nature of the Rule 15(b) amendment. Indeed, by virtue of the *sua sponte* procedure utilized in this case, under the circumstances present, a litigant can literally be deprived of property by a federal appeals court with absolutely no prior notice of the claim against him.

> The [Rule 15(b)] coin has another side, however; each party is entitled to know what is being tried, or at least to the means to find out. Notice remains a first-reader element of procedural due process, and *trial by ambush is no more favored here than elsewhere.*

Jimenez v. Tuna Vessel Granada, 652 F.2d 415, 420 (5th Cir. 1981) (emphasis added). See also *id* at 421-22; *International Harvester Credit Corporation v. East Coast Truck*, 547 F.2d 888, 890 (5th Cir. 1977); *MBI*

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2. At the same time he received a copy of the majority opinion of the court of appeals, he also received a copy of a letter from the clerk of that court, informing him that judgment had already been entered against him on the two new claims:

> Enclosed is a copy of the opinion of this Court filed today in the above case. Judgment in accordance with the opinion is also entered today.

(App. at 32.)

Motor Company, Inc. v. Lotus/East, Inc., 506 F.2d 709, 711-13 (6th Cir. 1974); *Conair Corp. v. N.L.R.B.*, 721 F.2d at 1371-73; *Cioffe v. Morris*, 676 F.2d, 539, 541-43 (11th Cir. 1982); *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208, 1218 (8th Cir.), *cert. denied*, 454 U.S. 968, 1084 (1981); and *Armstrong Cork Company v. Lyons*, 366 F.2d at 208-09.

2. The *sua sponte* addition of a new party-plaintiff in the opinion as filed by the court of appeals, in which opinion the appeals court orders entry of a money judgment in favor of the new party-plaintiff, is such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

This petition presents the question of whether a litigant has the due process right to know, at some point prior to entry of a money judgment against him, who it is that is asserting a claim against him.[3] The first indication petitioner received in this case that the Estate of Minnie C. Ehrichs was asserting a claim against him was when he read about it in the opinion of the court of appeals. (The opinion was accompanied by a letter from the clerk of that court, informing him that a money judgment "in accordance with the opinion" had already been entered against him, in favor of the Estate of Minnie C. Ehrichs.) (App. at 32.) Petitioner, after exhaustively researching the question, has found

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3. In Ex. 67, the accountant's summary relied upon by the court of appeals in ordering judgment in favor of the new party-plaintiff (the Estate of Minnie Ehrichs), the "M. [Minnie] Ehrichs note" is listed as one of some 135 debt entries as reflected on the books of the corporation. Minnie Ehrichs (or her estate, upon her death) was no more a party to this matter than any of the other 134 creditors, prior to entry of the majority opinion of the court of appeals.

no prior authority whatsoever for what the court of appeals did here. *No federal or state court has ever* before *sua sponte* added a new party-plaintiff to a lawsuit, in its opinion on the merits (post-trial, post-briefing, and post-argument), in which opinion the appeals court orders entry of a money judgment in favor of the new party-plaintiff. Nor is there any authority for a trial court's taking such action.

As the court in *Jimenez v. Tuna Vessel Granada* noted, each party to a lawsuit is entitled to know what issues are being tried between himself and his adversary. 652 F.2d at 420. It should go without saying that each party is likewise *entitled to know with whom he is litigating*—who is it that he is contesting with, and what is the basis for the issue that divides them.

This case additionally raises the question of whether and under what circumstances a federal appeals court can *sua sponte* add additional parties-plaintiff — without benefit of any motion by an existing party, and without benefit of a request to intervene by a non-party. In sum, can an appeals court add a party-plaintiff to a lawsuit, without any prior notice whatsoever to those already parties to the action.

3. The Rule 15(b), F.R.Civ.P., issue of "implied consent" raised and decided *sua sponte* in the majority opinion of the court of appeals involves an important question of federal law which has not been, but should be, settled by this Court.

This petition raises the question just what standards should apply in determining whether parties have "impliedly consented" to trial of issues not encompassed in the pleadings, under Rule 15(b). As the court noted in *Jimenez v. Tuna Vessel Granada*, 652 F.2d at 421:

Express consent to try such issues rarely presents problems; implied consent, however, is much more difficult to establish since it depends on whether the parties recognized that an issue not presented by the pleadings entered the case at trial. Where a party does not recognize the significance of evidence and so fails to contest it, he cannot realistically be said to have given his implied consent to the trial of unpled issues suggested by it, always assuming his failure to grasp its significance was reasonable. A prime example of such a circumstance occurs when evidence is introduced that is relevant to an issue already in the case and there is no indication that the party who introduced the evidence was seeking to raise a new issue. We have often so held. *International Harvester Credit v. East Coast Truck*, 547 F.2d 888, 890 (5th Cir. 1977); *Bettes v. Stonewall Insurance Co.*, 480 F.2d 92, 94-95 (5th Cir. 1973). Such was the case here.

All of the evidence upon which the court relied in finding . . . on unpled grounds was relevant in one degree or another to the issue made in the pleadings, ...

* * *

We conclude that the introduction of such evidence gave this defendant no fair notice that new issues were thereby entering the case, issues that it must meet or suffer an adverse judgment. Nor did the court give defendant any indication that it contemplated a disposition on such grounds;. . . .

Id. at 421 (footnotes omitted). The instant case as decided by the court of appeals below calls into question which of the following principles, enunciated by lower federal courts, should apply in Rule 15(b) amendment-to-conform-to-the-evidence situations:

(a) The introduction of evidence relevant to an issue already in the case may not be used to show consent to trial of a new issue *absent a clear indication that the party who introduced the evidence was attempting to raise a new issue. International Harvestor Credit Corporation v. East Coast Truck*, 547 F.2d at 890. See also 6 Wright & Miller, Federal Practice and Procedure: Civil § 1493, at 466 (1971).

(b) An implied amendment of the pleadings will not be permitted where it results in substantial prejudice to a party, "*i.e.*, whether he had a fair opportunity to defend and whether he could offer any additional evidence if the case were to be retried on a different theory." *International Harvester Credit Corporation v. East Coast Truck*, 547 F.2d at 890, quoting *Monod v. Futura, Inc.*, 415 F.2d 1170, 1174 (10th Cir. 1969). See also *Town of Orangetown v. Gorsuch*, 718 F.2d 29, 40 n. 10 (2d Cir. 1983); 6 Wright & Miller, Federal Practice and Procedure: Civil § 1493, at 467-68 (1971); 3 Moore's Federal Practice ¶ 15.13[2], at 173 (2d ed. 1984).

(c) "The purpose of an amendment to conform to proof is to bring the pleadings in line with the actual issues upon which the case was tried; therefore an amendment after judgment is not permissible which brings in some entirely extrinsic issue or changes the theory on which the case was actually tried, even though there is evidence in the record—introduced as relevant to some other issue—which would support the amendment. This principle is sound, since it cannot be said that there is any implied consent to

try an issue where the parties do not squarely recognize it as an issue in the trial." *Armstrong Cork Company v. Lyons*, 366 F.2d at 209 n. 3, quoting 3 Moore's Federal Practice ¶ 15.13[2], at 991-92 (2d ed. 1964). See also *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d at 1218; *McLeod v. Stevens*, 617 F.2d. 1038, 1040-41 (4th Cir. 1980).

(d) Even given facts suggesting implied consent, amendment of the pleadings should not be permitted where it would deny a party fair opportunity to present evidence material to newly added issues. *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d at 1218. See also *St. Joe Minerals Corp. v. O.S. & H. Review Com'n*, 647 F.2d 840, 844 (8th Cir. 1981).

(e) Implied consent under Rule 15(b) will not be found if the defendant will be prejudiced; that is, if the defendant had no notice of the new issue, if the defendant could have offered additional evidence in defense, or if the defendant in some other way was denied a fair opportunity to defend. *Cioffe v. Morris*, 676 F.2d at 539, 541-42.

(f) Implied consent will not be found unless the record reveals uncontrovertibly that a defendant could not have prevailed in any defense to the new claim. *McLean-Behm Steel Erectors, Inc. v. O. S. & H. Review Com'n*, 608 F.2d 580, 582 (5th Cir. 1979), citing *International Harvester Credit Corporation v. East Coast Truck*, 547 F.2d at 890-91.

(g) "[I]f the record is incomplete or if it is uncertain whether the party opposing the motion to amend had notice of the unpleaded issue at the trial stage, the appellate court should render its

decision in conformity with the issues relied upon by the lower court in reaching its judgment." *Conair Corp. v. N.L.R.B.*, 721 F.2d at 1372, quoting 6 Wright & Miller, Federal Practice and Procedure: Civil § 1494, at 478 (1971).

(h) Implied consent to the trial of an unpleaded issue is not established merely because evidence relevant to that issue was introduced without objection. At the very least it must appear that the parties understood the evidence to be aimed at the unpleaded issue. *MBI Motor Company, Inc. v. Lotus/East, Inc.*, 506 F.2d at 711. See also *Consol. Data Term. v. Applied Digital Data Systems*, 708 F.2d 385, 395-97 (9th Cir. 1983).

(i) "The test of consent by implication to the trial of claims not set forth in the complaint is whether a party did not object to the introduction of evidence or introduced evidence himself that was relevant *only* to that issue." *Lynch v. Dukakis*, 719 F.2d 504, 508-09 (1st Cir. 1983) (emphasis in original). Even if this test is met, amendment should not be allowed if it would prejudice a party. *Id.* at 509.

(j) The test whether pleadings should be deemed amended "is whether the opposing party had a fair opportunity to defend and whether it could offer additional evidence if the case were retried on the different theory. This is the standard described in 3 Moore's Federal Practice ¶ 15.13[2]. *The implied consent issue should be decided by the district court." R. A. Pohl Const. Co. v. Marshall*, 640 F.2d 266, 267 (10th Cir. 1981) (emphasis added), citing *Ellis v. Arkansas Louisiana Gas Company*, 609 F.2d 436, 439-40

(10th Cir. 1979), and *deHaas v. Empire Petroleum Company*, 435 F.2d 1223, 1228-29 (10th Cir. 1970). See also 6 Wright & Miller, Federal Practice and Procedure: Civil § 1493, at 469 (1971): "The decision whether the issue has been tried by express or implied consent is a matter of the *trial court's* discretion and will not be reversed except upon a showing of abuse." (Emphasis added.)

CONCLUSION

The Federal Rules of Civil Procedure are designed to avoid surprise, and thus to facilitate a proper ruling on the merits of each case. It is because of this that these Rules place a heavy emphasis on notice. The court in *Schlesinger Investment Partnership v. Fluor Corp.*, 671 F.2d 739 (2d Cir. 1982) noted:

> For instance, Rule 7(b) requires that applications to the court be made by motion in writing; Rule 6(d) requires that, in general, these be served not later than 5 days before the hearing; Rule 56(c) requires service of a motion for summary judgment 10 days before the day of the hearing. While it is true that these rules speak to actions proposed by the litigants rather than by the court, Rule 1 requires that the rules "be construed to secure the just . . . determination of every action." It seems to us that the notice requirement is meant not as a restriction on the moving party, but rather as a device for securing an opportunity for the non-moving party to muster his best argument, to plan his strategy, and to put his best foot forward. In short, adequate notice helps the court secure a just determination.

Id. at 742. This emphasis on notice is really nothing

more than affording litigants in federal courts the due process that is guaranteed them under the Due Process Clause of the Fifth Amendment. At a minimum, due process must mean that a litigant has the right to know, when he walks out of the courtroom at the conclusion of trial, just what causes of action he has litigated, and who it is he is litigating with—who is it who is seeking a money judgment against him. Rule 15(b) cannot be allowed as a device for "trial by ambush". *Jimenez v. Tuna Vessel Granada*, 652 F.2d at 420.

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit.

Respectfully submitted,

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Attorneys for Petitioner

June 22, 1984

APPENDIX A

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 83-1638

Warren Ehrichs,

Appellant,

v.

Robert D. Kearney,

Appellee.

Submitted: December 12, 1983

Filed: March 28, 1984

Before HEANEY, ROSS and FAGG, Circuit Judges.

HEANEY, Circuit Judge.

Warren Ehrichs appeals from a district court judgment in favor of Robert Kearney on Ehrichs' action for an accounting for the surplus of assets of Ehrichs Manufacturing Company after a foreclosure sale or for recovery of benefits under the theory of unjust enrichment. He alleges that the court erroneously denied him relief under either theory based on an oral agreement whereby Ehrichs transferred ownership of Ehrichs

Manufacturing to Kearney. We agree with the district court that the oral stock transfer agreement bars Ehrichs' recovery under the theories pled and argued. The record establishes, however, that Kearney breached his duties under that agreement and that Ehrichs suffered direct monetary damage from that breach. Because neither we nor the district court should be enslaved by technical rules of pleading where the parties fairly try issues not pled, we reverse the district court's judgment in part and remand for entry of judgment in favor of Ehrichs for money owed him personally and as administrator of his deceased mother's estate under the stock transfer agreement.

Warren Ehrichs formed Ehrichs Manufacturing in 1961 as a sole proprietorship. In 1969, he and Charles Gift, as co-owners, incorporated the company with its principal place of business in Fargo, North Dakota. Ehrichs purchased Gift's ownership interest in 1971 and was controlling stockholder from that year until the events surrounding this action.

Ehrichs Manufacturing did custom metal and machine fabrication in addition to manufacturing and marketing several patented products. One of its staple activities was the manufacture and sale of the "Kerbit," a slip-form machine which could lay concrete curb and gutter without the use of forms. Ehrichs Manufacturing built the Kerbit under license from its Australian inventor. The company borrowed heavily to finance its operations, principally from Fargo National Bank. Cash flow problems caught up with the business in the spring of 1979, and the bank accelerated its entire indebtedness of $687,709 for failure to make timely payments. The company could not pay the debt, so the bank sought foreclosure on its security interest in the corporation's inventory, equipment, and

intangible assets. Ehrichs signed a "Transfer of Collateral Upon Peaceable Foreclosure and Renunciation" in favor of the bank on April 20, 1979.

Robert Kearney, an Oregon businessman, was visiting Fargo at this time regarding the purchase of Kerbits from, and a possible distributorship agreement with, Ehrichs Manufacturing. He was in Ehrichs' office when bank officials first informed Ehrichs of their foreclosure designs and procured the transfer of collateral on April 20, 1979. Ehrichs, Kearney, bank officials, and others began several days of negotiations regarding the fate of Ehrichs Manufacturing assets and operations after the foreclosure. On April 23, the bank assigned to Kearney its position as secured party in possession of the bulk of the company's assets. At the same time, Ehrichs, Kearney, and Howard and Eugene Dahl agreed to transfer the realty, most of the shop equipment, and some of the inventory of Ehrichs Manufacturing to the Dahls, acting on behalf of their new business Concord, Inc., for $786,900. Kearney gave the bank a $75,000 check to cover back taxes on the company's realty to facilitate this transfer. The sale to Concord raised funds more than sufficient to completely extinguish Ehrichs Manufacturing's debt to the bank.

In the course of these dealings, Ehrichs and Kearney discussed a joint venture to continue the production and sale of the Kerbit. They reached an oral agreement to manufacture and market the machine together, either as Ehrichs Manufacturing or a new corporation. Under this agreement, Ehrichs was to provide the remaining assets of Ehrichs Manufacturing and be in charge of manufacturing, while Kearney was to supply additional capital—evinced by his prior $75,000 payment to the bank and the execution of a note to borrow

another $125,000—and to manage the marketing end of the operation. The outstanding debts of Ehrichs Manufacturing would be paid from its remaining assets and the sale of new Kerbits. A cash collateral account was opened at the bank to collect receivables and discharge the remaining payables of Ehrichs Manufacturing. Ehrichs was to receive a forty-nine percent ownership interest in the new operation with Kearney holding the remaining fifty-one percent interest.

Despite this agreement, Ehrichs and Kearney never became business partners. The parties differ as to the reasons for their falling out. The district court found that the two met for breakfast at the Perkins restaurant in Fargo a week or two after their forty-nine/fifty-one agreement was reached. Ehrichs expressed misgivings concerning his continued involvement in the manufacturing business since things had gone so bad for Ehrichs Manufacturing in the past. He stated that he did not want any part of the operation if he could not have complete control.

The court further found that Kearney made several efforts to persuade Ehrichs to abide by their forty-nine/fifty-one agreement and Ehrichs' responsibilities thereunder. Several days later, "Ehrichs signed over to Kearney all of his stock in Ehrichs Manufacturing, and Kearney agreed to settle the debts of Ehrichs Manufacturing." *Ehrichs v. Kearney*, Civil No. A3-81-71, slip op. at 6 (D. N.D. April 8, 1983). Kearney proceeded to use his total control of the company to negotiate reduced payments as satisfaction of some of the debts of Ehrichs Manufacturing and to transfer many of the company's assets to other companies which he effectively managed. He has to this date failed to extinguish several debts which appeared on

the books of Ehrichs Manufacturing at the time of the stock transfer, including two notes payable to Ehrichs personally and to his deceased mother, Minnie Ehrichs.

On February 5, 1981, Ehrichs instituted this action in the district court for Cass County, North Dakota. Kearney removed the action to federal district court and, on September 8, 1982, Ehrichs filed his first amended complaint, containing the allegations against Kearney which ultimately were tried before the district court. Ehrichs alleged that Kearney was to transfer forty-nine percent of the stock back to Ehrichs pursuant to their original forty-nine/fifty-one agreement after their falling out at the Perkins restaurant. He claimed a right to recover any profits made by Kearney from the disposition of Ehrichs Manufacturing assets under three theories: (1) that Kearney fraudulently entered the forty-nine/fifty-one agreement with no intention of following through, resulting in a rescission of that agreement; (2) that Kearney was responsible to Ehrichs for the surplus created by liquidating the assets of Ehrichs Manufacturing under the Uniform Commercial Code (UCC), N.D. Cent. Code § 41-09-50 (1983); or (3) that Kearney's profits from these transactions amounted to an unjust enrichment. Ehrichs' specific requests for relief were all for monetary recovery and related expenses.

The district court found, first, that Ehrichs' allegations of fraud were unsubstantiated and that the ultimate stock transfer to Kearney "was voluntary and constituted a new agreement between the parties." *Ehrichs v. Kearney, supra*, Civil No. A3-81-71, slip op. at 9. Second, it held that the UCC duty to account for the surplus of assets after foreclosure ran to the debtor,

Ehrichs Manufacturing, and not to Ehrichs personally. Finally it held that Ehrichs could not maintain his action under a theory of unjust enrichment/quasi-contract because North Dakota law allows such recovery only in the absence of an express or implied in fact contract. Ehrichs appeals only from the latter two holdings of the court.

The linchpin to this action is the existence and validity of the oral stock transfer agreement between Ehrichs and Kearney following their Perkins restaurant meeting. The district court found that such an agreement in fact was entered. Based on Ehrichs' own testimony, the depositions of both parties, and the exhibits in the record, we cannot say that this finding was clearly erroneous. *See* Fed.R.Civ.P. 52(a).

Moreover, Ehrichs' contentions on appeal regarding the legal validity of this agreement are unavailing.[1] Even assuming that contracts such as the stock transfer agreement normally must be in writing under the statute of frauds, *see* N.D. Cent. Code § 9-06-04 (1), (2) (1975); *but see Nelson v. TMH, Inc.*, 292 N.W.2d 580, 585 (N.D. 1980) (where promisor receives direct personal benefit, promise is original and thus outside the statute of frauds), the agreement has been partially performed, with Ehrichs' transfer of stock and Kearney's settling of some of the corporate debts, and thus is not invalid for want of a written memorial. *See Cooke v. Blood Systems, Inc.*, 320 N.W.2d 124, 129 (N.D. 1982); *Vasichek v. Thorsen*, 271 N.W.2d 555, 560-

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1. We assume for purposes of this opinion that each of Ehrichs' contentions was sufficiently raised below, although the record is none too clear on this score. We further apply North Dakota substantive law to this action, as did the district court and as the parties implicity agree to on appeal.

561 (N.D. 1978). Furthermore, Kearney's promise to settle the debts of the corporation, in addition to releasing Ehrichs from his obligations under the prior forty-nine/fifty-one contract, was more than sufficient consideration to support the stock transfer agreement. Finally, the district court's dismissal of Ehrichs' fraud claim and the facts in the record belie Ehrichs' claim on appeal that the agreement has been or should be rescinded. *See Robertson Companies, Inc. v. Kenner*, 311 N.W.2d 194, 197-198 (N.D. 1981); N.D. Cent. Code §§ 9-09-02, 9-09-04 (1975.)

Having found a valid agreement in fact transferring all Ehrichs' ownership interest to Kearney, the district court ruled correctly on Ehrichs' claim under the UCC and under the theory of unjust enrichment/quasi-contract. Kearney's UCC duty to account for the surplus of Ehrichs Manufacturing assets after the foreclosure sale ran to the debtor, which was the corporation itself. *See* N.D. Cent. Code § 41-09-50 (2) (1983). Once Ehrichs relinquished his ownership interest in the company, he no longer had any right to the surplus of its assets, directly or indirectly. Furthermore, North Dakota law makes clear that the remedy of unjust enrichment/quasi-contract is available only in the absence on an express or implied in fact contract such that alternative remedies are inadequate. *Midland Diesel Service & Engine Co. v. Silvertson*, 307 N.W.2d 555, 557-558 (N.D. 1981).

Thus, the district court was correct in denying Ehrichs any recovery under the theories he pursued below and presses upon us here. The facts relied on to reach that judgment and the record, however, show conclusively that Kearney breached at least part of the stock transfer agreement which was the basis for denying Ehrichs relief on the theories pled. Although

Ehrichs did not focus his lawsuit on Kearney's breach of the stock transfer agreement, a court may grant recovery on a theory not pled but fairly tried by both parties. *Charles Schmitt & Co. v. Barrett*, 670 F.2d 802, 806 (8th Cir. 1982). *See also* Fed. R. Civ. P. 15(b), 54(c); 5 C. Wright & A. Miller, Federal Practice and Procedure § 1219, p. 145 (1969); 6 C. Wright & A. Miller, Federal Practice and Procedure §§ 1493-1494, pp. 460-461, 475 (1971). This abrogation of the "theory of the pleadings" doctrine is likewise applicable on appeal where the resolution of an issue not pled may be made on the record without undue prejudice to any party's right to present evidence and argument on that issue. *Webb v. Hiykel*, 713 F.2d 405, 407-408 (8th Cir. 1983); *Morton Buildings of Nebraska, Inc. v. Morton Buildings Inc.*, 531 F.2d 910, 919 (8th Cir. 1976). *See also* 6 C. Wright & A. Miller, *supra*, § 1494, pp. 476-477.

In the instant case, both Ehrichs and Kearney put on evidence and argued as to the effects of their extended transactions, including the facts supporting the district court's finding of the stock transfer agreement and their actions subsequent to it. The court specifically found that Kearney "agreed to settle the debts of Ehrichs Manufacturing," but failed to go on to consider whether Kearney fulfilled that agreement and whether Ehrichs was harmed if in fact Kearney did fail to abide by it. [2] The record leaves no doubt that

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2. The district court found in a footnote to its memorandum opinion that there was "no evidence presented at trial sufficient for the court to find that Ehrichs Manufacturing was in fact indebted to Ehrichs or his mother, or that other corporate debts, if any, would not be settled from assets which Ehrichs Manufacturing continues to hold." *Ehrichs v. Kearney*, Civil No. A3-81-71, slip op. at 6, n.5 (D. N.D. April 8, 1983). Our review of the record, including the summary of Kearney's accounting expert,

Kearney's promise to settle the corporate debts of Ehrichs Manufacturing encompassed obligations to Ehrichs personally and to his deceased mother.[3] *See* Ehrichs Manufacturing Company Balance Sheet as of March 31, 1979, Pl. Exh. No. 2, Joint Appendix at 460, 461, 463; Summary of Thomas L. Elliot, CPA, Def. Exh. No. 67, Joint Appendix at 780, 782, 799; Plaintiff's Summary of Chuck Miller's Worksheet, Pl. Exh. No. 92, Joint Appendix at 964; Chuck Miller's Worksheet, Pl. Exh. No. 6, Joint Appendix at 476. Kearney has steadfastly refused to pay, settle, or otherwise discharge these debts. *See* Trial Testimony of Robert Kearney, Tr. at 32 (November 30, 1982), Joint Appendix at 270.

Thus we cannot escape the conclusion that Kearney breached the stock transfer agreement insofar as the corporate debts to Ehrichs and his deceased mother are concerned. The measure of damages for a breach of

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shows that all parties considered debts to Ehrichs and his deceased mother as corporate debts. Kearney's accounting summary included these obligations even though another allegedly disputed debt—to the estate of Ehrichs' former partner Charles Gift—was removed "upon advice of [Kearney's] counsel." *See* Summary of Thomas L. Elliot, CPA, Def. Exh. No. 67, Joint Appendix at 780, 782-783, 799. The district court's finding to the contrary is, therefore, cleary erroneous.

3. Ehrichs also argues that the stock transfer agreement included Kearney's promise to pay $24,800 plus interest to the estate of his former partner Charles Gift. Because the North Dakota Supreme Court decided that the Gift indebtedness was personal to Ehrichs, *Gift v. Ehrichs*, 284 N.W.2d 435, 439 (N.D. 1979), and the district court found that Kearney's promise encompassed only corporate debts, we cannot say Kearney's failure to reimburse Ehrichs for paying this debt constituted a breach of the stock transfer agreement.

contract is "the amount which will compensate the injured person for the loss which a fulfillment of the contract would have prevented." *Vallejo v. Jamestown College*, 244 N.W.2d 753, 758 (N.D. 1976). *See also* N.D. Cent. Code § 32-03-09 (1976). In this case, Ehrichs is entitled to recovery of the corporate debt owed him personally and, as administrator of his mother's estate, of the corporate debt to her.

From the exhibits in the record, it is apparent that the corporate books of Ehrichs Manufacturing showed balances on Ehrichs' and his mother's accounts on April 20, 1979, of $9,292 and $39,332 respectively. Summary of Thomas L. Elliot, CPA, Def. Exh. No. 67, *supra*, Joint Appendix at 782, 799; Plaintiff's Summary of Chuck Miller's Worksheet, Pl. Exh. No. 92 *supra*, Joint Appendix at 988; Chuck Miller's Worksheet, Pl. Exh. No. 6. *supra*, Joint Appendix at 476 (showing total due on the two notes as approximately $50,000). Furthermore, Kearney breached his obligation to settle these accounts at least as of May 21, 1979, when he met with his accountant Robert Brostrom and failed to recognize the debts to Ehrichs and his mother as outstanding liabilities. *See* Robert Brostrom's Notes (May 21, 1979), Pl. Exh. No. 13, Joint Appendix at 497, 498; Trial Testimony of Robert Brostrom, Tr. at 108-109 (November 30, 1982), Joint Appendix at 346-347. We thus find the above amounts to be conclusive as to the measure of damages experienced by Ehrichs, personally and as administrator of his mother's estate, resulting from Kearney's breach of the stock transfer agreement as of May 21, 1979.

Because the record could only support findings that Kearney breached the stock transfer agreement and that Ehrichs was damaged to the extent just discussed, a remand for further action with regard to

liability or damages would unnecessarily prolong this litigation. We therefore remand for entry of judgment in favor of Ehrichs personally and as administrator of the estate of Minnie Ehrichs, in the amount of $48,624 with legal interest accrued from May 21, 1979, until final judgment.

The amounts collected by Kearney on liquidation and transfer of Ehrichs Manufacturing assets were more than sufficient to meet this obligation, so we need not concern ourselves with whether Kearney should have to reach into his own pocket to satisfy this judgment. Should the remaining assets of the company be insufficient to remedy Ehrichs, that can only be attributed to Kearney's dealings and he will be personally liable for the balance under this judgment.

In sum, we affirm the district court insofar as to held that Kearney is not liable to Ehrichs under the UCC or under the doctrine of unjust enrichment/quasi-contract. We reverse, however, insofar as the court failed to award damages for Kearney's clear breach of the stock transfer agreement. We remand for entry of judgment in favor of Ehrichs, personally and as administrator of the estate of Minnie Ehrichs, in the amount of $48,624, with legal interest accrued from May 21, 1979.

The parties shall bear their own costs.

FAGG, Circuit Judge dissenting.

The majority concludes that "the district court was correct in denying Ehrichs any recovery under the theories he pursued below and presses upon us here." *Ante* at [24]. Despite its recognition that "Ehrichs did not focus his lawsuit on Kearney's breach of the stock

transfer agreement," *id.*, the majority reverses the district court on the basis of this theory that was not fairly pled or tried by both parties in the district court or raised on appeal. Because I see no justification for this result, I dissent.

By treating the breach of contract theory as if it were raised in the pleadings the majority in effect amends Ehrichs' pleadings *sua sponte* to conform to evidence in the record which is relevant to this theory. *See* Fed. R. Civ. P. 15(b); *Mason v. Hunter*, 534 F.2d 822, 825 (8th Cir. 1976). Generally, though, this analogy to Rule 15(b) is relied upon to support the judgment of the district court since "[a]ppellate courts seem unwilling to allow amendments that will result in the reversal or substantial alteration of the judgment." 6 C. Wright & A. Miller, Federal Practice and Procedure § 1494, at 477 (1971). Authority from our own court is consistent with this view:

> The issue now urged was clearly not presented to nor determined by the lower court. This is a court of appellate jurisdiction, and we are without authority, on the record before us, to determine this question, even though the parties consent thereto. It is true that, in certain exceptional circumstances, pleadings may be amended or deemed amended even in the appellate court, to conform to the proof for the purpose of sustaining the judgment, but this will not be allowed where such amendment would bring about the reversal of a judgment otherwise correct.

United States v. Winkle Terra Cotta, Inc., 110 F.2d 919, 922 (8th Cir. 1940). This reluctance of appellate courts to reverse a judgment on a new theory is under-

standable since the district court will not have had an opportunity to exercise its own judgment on the issues. Wright & Miller, *supra*, § 1494, at 477. In my view *Winkle* is still good law notwithstanding the liberality of modern pleading rules.

Even if we are not directly bound by precedent, considerations of fairness nonetheless dictate that we may not reverse on the basis of an alternate theory unless it appears clearly from the record that the issues involved were tried with the express or implied consent of the parties. *See* Fed. R. Civ. P. 15(b); Wright & Miller, *supra*, § 1494, at 478; *cf. Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208, 1218 (8th Cir.), *cert. denied*, 454 U.S. 968, 1084 (1981); *Armstrong Cork Company v. Lyons*, 366 F.2d 206, 208-09 (8th Cir. 1966); *Standard Title Insurance Co. v. Roberts*, 349 F.2d 613, 620-21 (8th Cir. 1965). Accordingly, "it cannot be fairly said that there is any implied consent to try an issue where the parties do not squarely recognize it as an issue in the trial." 3 J. Moore, Moore's Federal Practice ¶ 15.13[2], at 15-171 – 15-172 (1983); *see Dependahl*, *supra*, 653 F.2d at 1218, *Armstrong*, *supra*, 366 F.2d at 208-09; *Standard Title*, *supra*, 349 F.2d at 620-21; Wright & Miller, *supra*, § 1493, at 462. In the present case there was no express consent to try the issue of breach of the stock transfer agreement, so the inquiry pivots on whether such consent was implied.

The presence of evidence in the record which supports the majority's determination that Kearney breached the stock transfer agreement does not in and of itself warrant the conclusion that the issue was tried by consent. Implied consent to try a wholly different theory cannot be inferred merely from the unchallenged introduction of evidence relevant to the

new theory when the evidence is also relevant to issues already in the case. *See Dependahl, supra*, 653 F.2d at 1218; *Standard Title, supra*, 349 F.2d at 620; *see also* Moore, *supra*, ¶ 15.13[2] at 15-171 – 15-172; Wright & Miller, *supra*, § 1493, at 462-67. Evidence which supports the breach of contract theory embraced by the majority is also relevant to Ehrichs' action for an accounting for the surplus of corporate assets. Hence, there is nothing in the record clearly to indicate that the parties recognized that an issue not fairly presented by the pleadings had entered the case by consent at trial.

The unfairness resulting from reliance on a theory not advanced in the district court only compounds the prejudice which flows from the majority's raising an issue on appeal that was not submitted in the briefs. Kearney is thus not only denied the opportunity to present evidence on the new theory, but is in addition precluded from advancing arguments on appeal pertinent to the rationale of the majority's decision. Indeed, the outcome on appeal is beyond the realm of possibilities that Kearney might reasonably have foreseen. Without a minimum assurance of predictability on the part of this court, parties will simply be at a loss to decide what arguments and theories they should pursue on appeal. We should not raise and decide issues on our own motion without ensuring that the parties have had a fair opportunity to present evidence and arguments bearing on the resolution of those issues.

UNITED STATES COURTS OF APPEALS
FOR THE EIGHTH CIRCUIT

U.S. COURT & CUSTOM HOUSE
1114 MARKET STREET
ST. LOUIS, MISSOURI 63101

March 28, 1984

Mr. Nicholas J. Spaeth

Mr. Michael D. Nelson

Re: 83-1638—ND Warren Ehrichs v. Robert D. Kearney

Dear Sirs:

Enclosed is a copy of the opinion of this Court filed today in the above case. Judgment in accordance with the opinion is also entered today.

Please consult the appropriate Federal Rules of Appellate Procedure and the Eighth Circuit Rules (15 & 16) for post-opinion procedure, particularly circuit Rule 16(d).

Sincerely,

/s/

Robert D. St. Vrain
Clerk of Court

enc.
lkl

cc: Hon. Paul Benson, Chief Judge
Mr. Cletus J. Schmidt, Clerk-Fargo
A3-81-71

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

83-1638-ND September Term, 1983

Warren Ehrichs,

Appellant,

vs.

Robert D. Kearney,

Appellee.

Appeal From The United States
District Court for the
District of North Dakota

The Court, having considered appellee's petition for rehearing and suggestion for rehearing en banc and being now fully advised in the premises, hereby orders the petition for rehearing and suggestion for rehearing en banc denied.

April 26, 1984

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

JUDGMENT

No. 83-1638-ND September Term, 1983

Warren Ehrichs,

Appellant,

vs.

Robert D. Kearney,

Appellee.

Appeal from the United States
District Court for the
District of North Dakota

This appeal from the United States District Court was submitted on the record of the said District Court, briefs of the parties and was argued by counsel.

After consideration, it is ordered and adjudged that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part, reversed in part and remanded to the said District Court for proceedings consistent with the opinion.

It if further ordered that each party bear their own costs.

March 28, 1984

A true copy:
Attest:

/s/ Robert D. St. Vrain
CLERK, U.S. COURT OF APPEALS, 8TH CIRCUIT.
5/7/84

Let the within MANDATE be filed and entered on the Clerk's records, and judgment be entered accordingly.
Dated this 10th day of May, 1984

/s/ Paul Benson
CHIEF JUDGE, U.S. DISTRICT COURT

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NORTH DAKOTA SOUTHEASTERN DIVISION

Warren Ehrichs,

Plaintiff,

v.

Robert D. Kearney,

Defendant.

Civil No. A3-81-71

MEMORANDUM OF DECISION
AND
ORDER

In this action plaintiff Warren Ehrichs, the former principal stockholder of Ehrichs Manufacturing Co., Inc. (Ehrichs Manufacturing), has sued defendant Robert D. Kearney for breach of contract and seeks rescission and restitution and an accounting for surplus, either under the Uniform Commercial Code (U.C.C.) or a theory of unjust enrichment. Kearney has based his defense on a previous breach of the contract by plaintiff, an alteration of the initial agreement, and estoppel.

FINDINGS OF FACT

Warren Ehrichs is a resident of the State of Minnesota. Robert Kearney is a resident of the State of Oregon. Ehrichs Manufacturing was formed in 1961 as a sole proprietorship by Warren Ehrichs. It was incorporated in 1969, with its principal place of business in Fargo, North Dakota. Charles Gift was co-owner of Ehrichs Manufacturing from the date of incorporation until 1971, when Ehrichs acquired Gift's ownership interest.

In addition to contract metal fabricating, Ehrichs Manufacturing manufactured and marketed several products. The "Kerbit" slip-form curb and gutter machine, a paving machine that lays concrete curb and gutters without the use of forms, was manufactured under license from its inventor, William Rochfort, an Australian. Ehrichs Manufacturing was to pay Rochfort a royalty of $2,000 per machine. Additionally, Ehrichs Manufacturing manufactured the "Easy Reach Pallet Stand" under license from its inventor, Warren Ehrichs. The pallet stand patent was later assigned to Ehrichs Manufacturing.

While in business, Ehrichs Manufacturing borrowed large sums of money, principally from Fargo National Bank. Additional money was owed by the company to Ehrichs, plaintiff's mother Minnie Ehrichs, and Fargo-Cass County Industrial Development Corporation. The balance sheet of Ehrichs Manufacturing as of March 31, 1979[1] reveals that by this date the company had accumulated assets in excess of $1,700,000 and a stockholders equity reflecting a net worth in excess of $334,000.

Because Ehrichs Manufacturing was experiencing

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1. Trial Exhibit 2.

cash flow problems, on April 20, 1979 Fargo National Bank declared Ehrichs Manufacturing's entire indebtedness of $687,709 immediately due and payable. Because Ehrichs Manufacturing was unable to pay the debt, the bank sought to foreclose on its security interest.[2] Charles Miller and Billy Nustad, the president and assistant vice president respectively of Fargo National Bank, presented a document entitled "Transfer of Collateral Upon Peaceable Foreclosure and Renunciation"[3] to Ehrichs at his office on April 20, 1979.

After discussing the matter with Miller and Nustad, Ehrichs signed the document. Ehrichs did not consult a lawyer before signing because his wife had died nine days earlier and he was in a depressed and acquiescent mental state; additionally, he had a good relationship with Miller and trusted him. The foreclosure document provided that "the Bank will account to the Debtor for any surplus and the Debtor will be liable to the Bank

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2. In order to secure its position Fargo National Bank had taken a security interest in the following property of Ehrichs Manufacturing:

> All accounts receivable now owed or hereafter acquired. All inventory, raw or manufactured, now owned or hereafter acquired. All manufacturing and processing rights, patents, patent rights, licenses, trademarks, trade names and copyrights now owned or hereafter acquired. All shop equipment, tools, office furniture and office machines now owned or hereafter acquired. The following proceeds of collateral are also covered: Cash on hand, bank accounts, accounts receivable and negotiable paper.

Trial Exhibit 3. Products of collateral were also covered. *Id.* A financing statement listing the above collateral was filed with the North Dakota Secretary of State on October 4, 1972 and continued on September 23, 1977.

3. Trial Exhibit 4.

for any deficiency on disposition of collateral." Trial Exhibit 4.

Defendant Kearney was present in Ehrichs' office when Miller and Nustad arrived. Kearney, a businessman from Tigard, Oregon owning controlling interests in several corporations and businesses, had earlier purchased a demonstrator model of the Kerbit and had come to Fargo to pick up two additional machines. It was Kearney's desire that he become a distributor for the Kerbit and he had brought a tentative agreement to this effect along with him for Ehrichs to consider.

Several days of negotiations between Ehrichs, Kearney, Fargo National Bank, and Howard and Eugene Dahl followed the foreclosure. On April 23, the bank assigned, and Robert Kearney assumed its position as secured party in possession of the assets of Ehrichs Manufacturing. Trial Exhibit 8. Prior to the assignment Ehrichs had contacted Howard and Eugene Dahl about their possibly purchasing the Ehrichs Manufacturing real estate and equipment for their new business, Concord, Inc. After the assignment, Kearney continued to negotiate with the Dahls. An agreement was reached by Kearney and the Dahls whereby the Dahls would purchase the real estate, the bulk of the shop equipment, and a portion of the inventory of Ehrichs Manufacturing for $786,900. Trial Exhibit 9. This amount completely satisfied the indebtedness of $687,709 to Fargo National which Kearney had assumed, and after the payment of taxes on the property by Kearney[4] left a surplus of

4. Prior to selling the real estate to Concord, Kearney had given the bank a check for $75,000, which was apparently used to pay back taxes.

$23,281.00.

Prior to the assignment to Kearney or the sale of assets to Concord, Ehrichs and Kearney had discussed the possible continued production of the Kerbit. After the assignment and sale Ehrichs and Kearney orally agreed to establish a new business together to manufacture the Kerbit with the remaining Ehrichs Manufacturing assets. Under the terms of this oral agreement Ehrichs and Kearney were to manufacture, market and sell the Kerbit Curb and Gutter Machine either under the Ehrichs Manufacturing corporate shell, or under a new corporation. Ehrichs was to provide the assets remaining in Ehrichs Manufacturing (principally the Kerbit inventory) and to be in charge of manufacturing the Kerbits, while Kearney was to supply the capital necessary to make additional machines and market the machines. The outstanding debts of Ehrichs Manufacturing would be paid from accounts receivable, and from sales of Kerbit machines. Ehrichs was to receive a 49% ownership interest in the operation and Kearney a 51% interest.

The agreement between Ehrichs and Kearney was never reduced to writing. However, Ehrichs signed a number of documents to enable the collection of Ehrichs Manufacturing receivables and the liquidation of other assets. *See* Trail Exhibits 10 (assignment of Ehrichs Manufacturing receivables to a cash collateral set up by Kearney); 11 (a promissory note in the amount of $200,000 to Kearney); 46, 48, 54-56 (security agreements and financing statements to secure the $200,000 promissory note with Ehrichs Manufacturing assets).

In spite of the above mentioned arrangements, Ehrichs and Kearney never went into business together. After accounts were set up at Fargo Na-

tional for the collection of Ehrichs Manufacturing receivables and the proceeds to be realized upon the sale of Kerbits and a notice of assignment had been sent by Fargo National Bank to debtors of Ehrichs Manufacturing, Ehrichs indicated to Kearney that he no longer wanted to go into business with him. At a meeting between Ehrichs and Kearney at the Perkins restaurant in Fargo, Ehrichs stated that he didn't want to go into business with Kearney because he (Ehrichs) was bad luck, and that if he couldn't own 100 percent of the company he didn't want any part of it.

Kearney would not have purchased the bank's position if he had known Ehrichs wouldn't go into business with him. At a meeting with Ehrichs at the bank at which Miller was present, Kearney attempted to get Ehrichs to change his mind. Ehrichs remained adamant and several days later Ehrichs signed over to Kearney all of his stock in Ehrichs Manufacturing, and Kearney agreed to settle the debts of Ehrichs Manufacturing. Neither Ehrichs nor Kearney considered the stock to have much value, but Kearney wanted it as a means of extricating himself from the position he was in after Ehrichs backed away from their agreement to go into business together.

After having acquired the stock in Ehrichs Manufacturing, Kearney proceeded to liquidate the assets of Ehrichs Manufacturing and to settle the debts of the corporation. Kearney met with Robert Brostrom, an accountant, on May 20, 1979 to discuss the tax consequences of the sale of Ehrichs Manufacturing assets. At this meeting, Kearney stated that the outstanding liabilities of Ehrichs Manufacturing totaled $69,085.00, excluding "debts" which Ehrichs believes the company

owes to him.[5] Kearney has since paid out $4,028.14 for approximately $40,000 of these debts, settling each for approximately ten percent of the original amount.

Several days after the meeting with Brostrom, a corporation called P. K. Manufacturing was formed to manufacture the curb and gutter machines. Kearney was not listed as an incorporator in this company. Additionally Kearney denies that he owns any interest in P. K. Manufacturing or that he in any way manages or controls it. Kearney testified at trial that P. K. Manufacturing was formed when he had sold his share of the Ehrichs Manufacturing business to Paul Pawlak, a former Ehrichs Manufacturing employee, by loaning Pawlak $7,000. Kearney was repaid when his daughter Patricia purchased Pawlak's interest for $7,000. Since its formation it appears, however that Kearney has played an active role in running P. K. Manufacturing.

After the formation of P. K. Manufacturing, the remaining assets of Ehrichs Manufacturing were transferred to it. These assets consisted principally of the Kerbit inventory, Kerbit tooling, shop and office equipment and product development costs. In return for the transfer of these assets Ehrichs Manufacturing was given an account receivable from P. K. Manufacturing for the Kerbit inventory in the amount of $56,941.00. Exhibit 67 at 2, 8. No credit was given for the transfer of the other assets, money in a company checking account, tax refund checks, a motor home, an automobile, and a lathe had also been liquidated, with

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5. There was no evidence presented at trial sufficient for the court to find that Ehrichs Manufacturing was in fact indebted to Ehrichs or his mother, or that other corporate debts, if any, would not be settled from assets which Ehrichs Manufacturing continues to hold.

the proceeds apparently going to Kearney.

Plaintiff Ehrichs commenced this lawsuit after he decided not to go into business with Kearney and after he had transferred his Ehrichs Manufacturing stock to Kearney. On September 8, 1982, plaintiff filed an amended complaint alleging that Kearney entered into the oral agreement with him with no intention of complying with it, that Kearney failed to account to him for surplus upon disposition of the Ehrichs Manufacturing assets as required by the Uniform Commercial Code, and that Kearney's retention of this surplus constitutes unjust enrichment. Defendant Kearney's answer to plaintiff's amended complaint, filed September 29, 1982 alleges that plaintiff Ehrichs breached the contract, that plaintiff's actions and defendant's assent thereto affected an alteration of the initial oral agreement, and that by virtue of his actions plaintiff is estopped from recovering any damages.

APPLICABLE LAW

The principal remedy claimed by plaintiff is an accounting and restoration to him of the surplus received by Robert Kearney upon the liquidation of the assets of Ehrichs Manufacturing. In the alternative, plaintiff seeks the equitable remedy of restitution for the value of his ownership interest in the company and punitive damages for fraud.

Plaintiff's right to surplus theory hinges on the validity of Ehrichs' stock transfer to Kearney. In assuming the bank's position, Kearney assumed the duty of the bank to "account to the Debtor [Ehrichs Manufacturing] for any surplus. . . ." Trial Exhibit 4. *See also* N.D. Cent. Code § 41-09-50 (2) (a secured party has an express obligation to "account to the debtor for any surplus" upon disposition of collateral after default);

John Deere Co. v. Nygard Equipment, Inc., 225 N.W.2d 80,88 (N.D. 1974). It is the debtor and indirectly the shareholders in the debtor corporation who are entitled to recover any surplus received by Kearney. If the transfer of the stock to Kearney is valid, Ehrichs is no longer a shareholder, nor would he have been at the time the assets were liquidated. Ehrichs individually is not the debtor and therefore would not be entitled to recover. Ehrichs Manufacturing has not been liquidated. Although not presently in the business of manufacturing, it still possesses at least one and possibly two valuable assets,[6] and has filed income tax returns for every fiscal year since the date of foreclosure. The surplus, if any, remains a receivable of the corporation.

In his attempt to invalidate the stock transfer, plaintiff has alleged fraud. Fraud must be proved by evidence that is clear, satisfactory and convincing. *Jones v. Jones*, 310 N.W. 2d 753,757 (N.D. 1981). Additionally, in order to prove fraud, a party must show that the representations made were made with knowledge of their falsity and with intent to deceive, and that he relied upon the alleged false and fraudulent representations. *Buehner v. Hoeven*, 228 N.W.2d 893,904 (N.D. 1975).

The court holds the evidence does not support plaintiff's allegations of fraud. The basis for the fraud claim appears to be the allegation that Kearney entered into an oral contract with no intention of performing and deliberately misrepresented his intention in order to

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6. Trial testimony reveals that Ehrichs Manufacturing owns an account receivable from P. K. Manufacturing valued at at least $56,000 and perhaps as much as $150,000 for the Kerbit inventory, and possible a lathe valued at approximately $8,000.

induce Ehrichs to act to his detriment. Although the testimony at trial differs as to his reason for doing so, it is clear that Ehrichs, not Kearney, is the one who materially breached the oral agreement when he refused to go into business with Kearney. The stock transfer was voluntary and constituted a new agreement between the parties. Part of that agreement was Kearney's assurance that he would take care of the corporate debts. Ehrichs disagrees with the manner in which the debts were handled, but there has been no showing that Ehrichs was fraudulently induced to either enter into the original oral agreement or the substitute agreement which resulted in the transfer of the stock.

As noted above, the duty to account for surplus is for the benefit of the debtor. The debtor involved in this case is Ehrichs Manufacturing. When Ehrichs transferred his stock to Kearney, he transferred all of his rights as a shareholder in the corporation, including his equitable ownership of the property of the corporation. There having been no fraud in the transfer of the stock, and the right to surplus belonging to the corporation, Kearney and not Ehrichs is the equitable owner of the property of the corporation and is entitled to any profits derived from the sale of corporate assets and surplus. There being no duty under the Uniform Commercial Code to account to Ehrichs, plaintiff is not entitled to recover the surplus, if any, realized upon the sale of Ehrichs Manufacturing assets.

Plaintiff's final claim is based on the equitable theory of unjust enrichment. In order for plaintiff to recover under this theory, it is necessary to establish the following: an enrichment; an impoverishment; a connection between the impoverishment and the un-

just enrichment; an absence of justification for the enrichment and impoverishment; and an absence of a remedy at law. *A and A Metal Buildings v. I-S, Inc.*, 274 N.W.2d 183,189 (N.D. 1978). The mere fact that a person benefits at the expense of another is not sufficient to require restitution. *Gate City Savings and Loan v. International Business Machine Corp.*, 213 N.W.2d 888,893 (N.D. 1973). A claim for unjust enrichment must be based upon an element of misconduct, fault, or undue advantage, and in the absence of fraud or bad faith a person is not entitled to recover for unjust enrichment if he received the consideration that was agreed upon from the other party. *Jerry Harmon Motors, Inc. v. Heth*, 316 N.W.2d 324,328 (N.D. 1982).

The court holds plaintiff has failed to prove he is entitled to recover under the theory of unjust enrichment. When Ehrichs decided not to go into business with Kearney, the stock was transferred to Kearney. While there is disagreement between Ehrichs and Kearney as to whether Kearney asked for the stock or Ehrichs offered it, the transfer was clearly a voluntary transaction which arose out of Ehrichs' decision not to go through with the oral agreement. When Kearney was unsuccessful in his effort to get Ehrichs to reconsider his decision to pull out, he accepted the stock. The stock transfer constituted a new arrangement which was in effect a new contract between the parties. Under North Dakota law a party may recover under the theory of unjust enrichment only in the absence of an express or implied in fact contract. *Midland Diesel Service and Engine Co. v. Sivertson*, 307 N.W.2d 555,557 (N.D. 1981).

In summary, Kearney did not defraud Ehrichs; Ehrichs, not Kearney, was the party who breached the oral agreement; under the circumstances Kearney's

conduct was proper and the transfer of the stock which terminated the oral agreement was not an unjust enrichment.

ORDER FOR JUDGMENT

IT IS ORDERED that judgment be entered for the dismissal of plaintiff's complaint and cause of action.

Dated this 8th day of April, 1983.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NORTH DAKOTA
SOUTHEASTERN DIVISION

Warren Ehrichs,
Plaintiff-Appellant,

v.

Robert D. Kearney,
Defendant-Appellee.

Civil No. A3-81-71
Appeal No. 83-1638-ND

JUDGMENT PURSUANT TO MANDATE OF
UNITED STATES COURT OF APPEALS

Pursuant to the MANDATE of the United States Court of Appeals,

IT IS ADJUDGED the judgment entered April 8, 1983 dismissing Plaintiff's complaint and cause of action is affirmed on the dismissal of claims grounded on the UCC and on the doctrine of unjust enrichment/ quasi-contract.

IT IS FURTHER ADJUDGED that Plaintiff Warren Ehrichs, personally and as administrator of the estate of Minnie Ehrichs, recover from Defendant Robert D. Kearney the sum of $48,624.00, with legal interest at the rate of 6% per annum accrued from May 21, 1979, as damages for breach of stock transfer agreement. Costs are not awarded to either party.

Dated this 10th day of May, 1984.

APPENDIX C
STATE OF NORTH DAKOTA
COUNTY OF TRAILL
IN COUNTY COURT
PROBATE FILE NO. 5117

IN THE MATTER OF
THE ESTATE OF
MINNIE C. EHRICHS,

Deceased.

ORDER APPOINTING ADMINISTRATORS

The petition of Wilbert Ehrichs, Leonard Ehrichs and Warren Ehrichs, praying that Letters of Administration of the estate of said decedent, be issued to Wilbert Ehrichs, Leonard Ehrichs and Warren Ehrichs coming on regularly to be heard; and due proof having been made to this Court that due and legal notice of the time and place of the hearing of said petition has been duly given or waived in accordance with law, and said matter being duly called, and the Court finding from the evidence submitted that the said Minnie C. Ehrichs died on the 9th day of May, 1974, intestate, in the Village of Halstad in the County of Norman, State of Minnesota, that she was a resident of the Village of Halstad in the County of Norman, in the State of Minnesota at the time of her death, and that she died seized of certain estate within the said County of Traill, in the State of North Dakota, and within the jurisdiction of this Court;

That the said Wilbert Ehrichs, Leonard Ehrichs and Warren Ehrichs are legally competent and are the sons of said decedent, and is [sic] entitled to Letters of Administration of said estate;

That the personal property belonging to said estate, within the jurisdiction of this Court, is of the value of None Dollars, and that the annual rents, profits and income of the real estate belonging to said estate, within the jurisdiction of this Court, is of the probable value of Seven Thousand & no/100 ($7,000.00) Dollars;

IT IS ORDERED, ADJUDGED AND DECREED, That Letters of Administration of the estate of said decedent, issue to Wilbert Ehrichs, Leonard Ehrichs & Warren Ehrichs as prayed for in said petition.

Dated this 27th day of May, 1975.

By the Court:
/s/ Howard Carver
Judge of the County Court

State of North Dakota
County of Traill

I hereby certify that I have carefully compared the within instrument with the original now on file in this office and that it is a true and correct copy of same.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal of this office this 30th day of May, 1984.

/s/ Howard Carver
Clerk of County Court

STATE OF NORTH DAKOTA
COUNTY OF TRAILL
IN COUNTY COURT
PROBATE FILE NO. 5117

IN THE MATTER OF
THE ESTATE OF
MINNIE C. EHRICHS,

Deceased.

LETTERS OF ADMINISTRATION

WHEREAS, Wilbert Ehrichs, Leonard Ehrichs and Warren Ehrichs were appointed Administrators of the estate of Minnie C. Ehrichs, Deceased, by the Order of the County Court of said County, of date 27th May A.D. 1975, and has [sic] duly qualified accordingly;

NOW, THEREFORE, Know ye, that said Wilbert Ehrichs, Leonard Ehrichs & Warren Ehrichs are authorized to enter upon the discharge of their duties as such Administrators and continue therein until the revocation of these letters.

Given with the seal of said Court hereto affixed the 27th day of May A.D. 1975.

/s/ Howard Carver
Judge of the County Court

STATE OF NORTH DAKOTA
COUNTY OF TRAILL

We, Wilbert Ehrichs, Leonard Ehrichs & Warren Ehrichs, do solemnly swear that we will support the Constitution of the United States and the Constitution of the State of North Dakota, and that we will faithfully and according to law, to the best of my [sic]

ability, perform all the duties of my [sic] trust and office as Administrators of the estate of Minnie C. Ehrichs, Deceased.

Subscribed and sworn to before me this 23rd day of May, 1975.

Carlene Bentley
Notary Public
Cass County, North Dakota
My Commission expires: 1/31/79

/s/ Wilbert Ehrichs
/s/ Leonard Ehrichs
/s/ Warren Ehrichs

State of North Dakota
County of Traill

CERTIFICATE

I, the undersigned, Howard Carver, Clerk of the County Court of said County hereby certify that the foregoing is a full, true and correct copy of the original Letters on file in my office and that on the date of this certificate they were in full force and effect.

Dated May 30, 1984.

/s/ Howard Carver
Clerk of Court